

Message Text

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ACTION ARA-14

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SUBJ: RECENT DEVELOPMENTS IN PERU'S FOREIGN EXCHANGE MARKETS -
FINANCIAL CRUNCH SEVERE

1. SUMMARY. SINCE THE BEGINNING OF APRIL THERE HAVE BEEN
SIGNIFICANT CHANGES IN PERU'S FOREIGN EXCHANGE MARKETS. IN
EARLY APRIL THE CD (CERTIFICATE OF DEPOSIT) EXCHANGE RATE
BROKE OUT OF THE S/.155-165 PER DOLLAR RANGE WHICH HAD
PREVAILED SINCE BEGINNING OF YEAR, AND HAS BEEN INCREASING ON A
WEEKLY, IF NOT DAILY, BASIS. THIS WEEK THE CD RATE IS IN THE
S/215-220 PER U.S. DOLLAR RANGE. THE OFFICIAL (OR GENTLEMEN'S
AGREEMENT) EXCHANGE RATE (DEVALUED FROM S/.130-TO S/.140 ON
MAY 10) IS BEING APPLIED TO FEWER SALES OF FOREIGN EXCHANGE BY
PERUVIAN COMMERCIAL BANKS, AND OVERCHARGES PAID BY BUYERS VIA
BANKS TO SELLERS HAVE BECOME A COMMON PRACTICE. SCARCITY OF
FOREIGN EXCHANGE IS OBVIOUSLY THE FUNDAMENTAL CAUSE OF THE
ESCALATING CD RATE AND EROSION OF THE OFFICIAL RATE. HOWEVER,
CURRENT BANKING PRACTICES, AS REVEALED IN RECENT INTERVIEWS,
FOCUS ON NEED TO MAINTAIN SOLVENCY AND AVOID OVEREXPOSURE IN
ADVANCE ACCOUNTS. SITUATION WILL BECOME EVEN MORE ACUTE IF
ANTICIPATED ROLLOVER OF PUBLIC SECTOR FOREIGN MATURITIES
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DOES NOT TAKE PLACE VERY SOON. EVEN IF DEFAULTS ARE
AVOIDED, EXTREME CRUNCH COULD CAUSE DISORDERLY INTER-
RUPTION OF IMPORTS AND ADVERSELY EFFECT IMPORT-TIED
DOMESTIC PRODUCTION. END SUMMARY.

2. A SURVEY OF EXCHANGE RATES. THE MAY 10 EDITION OF
CARETAS MAGAZINE (A LIMA BIWEEKLY) CONFIRMS OUR BANKER

INTERVIEW FINDINGS ON CURRENT EXCHANGE RATES FROM A BUYER'S VIEWPOINT -- WITH THE FOLLOWING TONGUE-IN-CHEEK "DEFINITIONS." A "CD" (CERTIFICATE OF DEPOSIT) IS FOREIGN EXCHANGE WHICH IS ACTUALLY OR FICTIONALLY REPATRIATED AND IT IS PRESENTLY PRICED AT S/.210. AN "EXCHANGE CERTIFICATE" COMES FROM EXPORTS; IT IS CHEAP, ONLY S/.130 (NOW S/.140); HOWEVER, IT IS UNAVAILABLE BECAUSE THE CENTRAL BANK MONOPOLIZES IT. A "DIRECTED CERTIFICATE" WAS INVENTED BY BANKERS, LASTED THREE DAYS AND WAS QUOTED AT S/.160. A "BROKER'S DOLLAR" WAS ON SALE AT S/.140 (WHEN THE OFFICIAL RATE WAS S/.130) WITH A S/.10 CHARGE OF AN INTERMEDIARY BUT IT HAS CEASED TO EXIST. A "TOURIST DOLLAR" COSTS S/.210 (BECAUSE THERE IS NO FOREIGN EXCHANGE AT S/.140 FOR TOURISTS) AND IT CAN ONLY BE PURCHASED IN MINIMUM QUANTITIES OF U.S. \$1,000 PLUS TAXES ON TRAVEL. THE "BOOK DOLLAR" IS QUOTED AT ABOUT S/.300 AND IS CHARGED BY IMPORTERS TO BOOKSTORES AND IS CALCULATED ON AN AVERAGE ANNUAL BASIS -- TAKE IT OR LEAVE IT. THE "AUTOMOBILE DOLLAR" IS QUOTED AT ABOUT S/.120 BECAUSE THE ASSEMBLY PLANTS INCREASED PRICES LAST YEAR AND THEIR SALES DECREASED BY 25 PERCENT. FINALLY, ACCORDING TO CARETAS, THERE IS THE "DOLLAR THAT IS NOT PAID, IT IS CHEAP; IT ONLY COSTS TWO VALIUM "PILLS".

3. DECREASED AGAILABILITY OF EXPORT PROCEEDS. THERE LIMITED OFFICIAL USE

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ARE VARIOUS METHODS OF CALCULATING THE PERCENTAGE OF RETENTION OF EXPORTS PROCEEDS BY THE CENTRAL BANK. (THE BASIC LEGAL SYSTEM IMPLEMENTED ON OCTOBER 10, 1977 REQUIRES THAT EXPORT PROCEEDS MUST BE SURRENDERED TO THE CENTRAL BANK AND EXPORT CERTIFICATES WITH A FOUR-DAY VALIDITY ARE ISSUED BY THE CENTRAL BANK WHICH ARE THEN SOLD BY THE OWNER TO COMMERCIAL BANKS. THE VALUE OF THE EXPORT CERTIFICATE IS EQUAL TO THE SURRENDER VALUE LESS EXPORT TAXES -- NOW PAYABLE IN FOREIGN EXCHANGE -- LESS A CERTAIN CASH-OUT PERCENTAGE, WHICH IS PAID IN SOLES AT THE OFFICIAL EXCHANGE RATE BY THE CENTRAL BANK.) IN MARCH THE CENTRAL BANK'S BASIC CASH-OUT PERCENTAGE WAS INCREASED FROM 35 PERCENT TO 45 PERCENT. FOR TRADITIONAL EXPORTS, EXPORT TAXES ARE 17.5 PERCENT AND OTHER TAXES ARE 3 PERCENT. ACCORDING TO THE CALCULATIONS BASED ON THE ABOVE, ONE BANK INFORMANT PLACED THE AVERAGE PERCENTAGE OF ALL EXPORT PROCEEDS RETAINED BY THE CENTRAL BANK AT 53 PERCENT. HOWEVER, A SECOND BANKER STATED THAT ONLY ABOUT 30 PERCENT OF EXPORT PROCEEDS WERE AVAILABLE TO COMMERCIAL BANKS TO SERVICE THE LIQUIDATION OF PRIVATE SECTOR IMPORT-RELATED CREDITS AND OTHER REQUIREMENTS. HE STATED THE 47

PERCENT FIGURE WAS MATHEMATICALLY CORRECT BUT OTHERWISE
INCORRECT BECAUSE EXPORTERS WERE HOLDING BACK ON THE
ACCEPTANCE OF LIQUIDATION DUE TO THE EXPECTATION OF
DEVALUATION (THIS WAS PARTICULARLY EVIDENT FOR
NON-TRADITIONAL EXPORTS) AND THAT THE BANCO DE LA NACION
WAS ALSO HOLDING BACK ON SALE OF FOREIGN EXCHANGE
ACQUIRED BY PRE-EXPORT FINANCING OPERATIONS ON BEHALF OF
STATE ENTERPRISES TO ENLARGE ITS FOREIGN EXCHANGE FLOAT.
THE CARETAS ARTICLE (CITED ABOVE AND REFERRING
THE THE PRESENT SITUATION) STATES, "IT IS ESTIMATED THAT
THE ACTUAL PRESENT SUPPLY (FROM EXPORT CERTIFICATES TO
PRIVATE SECTOR USERS) IS \$15 MILLION PER MONTH WHILE THE
DEMAND FOR IMPORTED GOODS (BY THE PRIVATE SECTOR) IS \$60
MILLION PER MONTH."
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4. THE EFFECTS OF CONSTRICTED SUPPLY OF OFFICIAL
MARKET FOREIGN EXCHANGE. ALL BANK INTERVIEWEES INDICATED
THAT THE SHARPLY RISING CD RATE WAS DUE TO THE
CONSTRICTED SUPPLY OF EXPORT PROCEEDS. ONE BANKER
ASSERTED THAT NEARLY ALL COMMERCIAL BANKS HAVE HAD TO
UTILIZE FOREIGN EXCHANGE PROCEEDS FROM THE S/.140 RATE
TO SERVICE THE REQUIREMENTS OF CUSTOMERS REPAYING LETTERS

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OF CREDIT AND OTHER OPERATIONS GUARANTEED BY THE BANKS, AND THERE WAS NOT SUFFICIENT FOREIGN EXCHANGE TO HANDLE THE REQUIREMENTS OF CUSTOMERS COLLECTIONS, I.E. OPEN ACCOUNTS. A SECOND BANKER STATED THAT HIS BANK IS UTILIZING ITS OWN FOREIGN EXCHANGE (INCLUDING DIRECT BORROWINGS) TO LIQUIDATE THE MATURING LETTERS OF CREDIT OF CLIENTS BECAUSE IT HAS BEEN RUNNING TWO TO THREE WEEKS LATE IN OBTAINING FOREIGN EXCHANGE FROM THE OFFICIAL MARKET SINCE EARLY APRIL. A THIRD BANK REPORTS THAT IT GIVES PREFERENCE TO CUSTOMERS LIQUIDATING LETTERS OF CREDIT ACCORDING TO A FORMULA OF 40 PERCENT FROM EXPORT CERTIFICATES AND 60 PERCENT FROM CD'S. COMMERCIAL BANKS HAVE ALSO SEVERELY RATIONED SALES OF FOREIGN EXCHANGE AT THE OFFICIAL RATE FOR USES NOT RELATED TO IMPORT FINANCING; ONE BANK REPORTS THAT IT IS REFUSING TO SELL FOREIGN EXCHANGE AT THE S/.140 RATE FOR TOURIST AND STUDENT REMITTANCES WHILE IT IS ANOTHER BANK'S POLICY THAT ONLY SCHOOLING, MEDICAL, AND EXPORTER PROFIT AND ROYALTY REMITTANCES ARE HANDLED AT THE S/.140 RATE, WHILE ALL OTHER BUSINESS REMITTANCES AND TOURIST SALES ARE AT THE CD RATE. ALL THREE BANKS INTERVIEWED STATE THAT THEY ARE WILLING AND ABLE TO SELL FOREIGN EXCHANGE AT THE CD RATE.

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5. REDUCTION IN OPENING LETTERS OF CREDIT. BANKS HAVE DRASTICALLY REDUCED THE PACE OF OPENING OF LETTERS OF CREDIT IN THE PAST TWO MONTHS -- IN ONE CASE BY AN ESTIMATED 70 PERCENT. BANKS HAVE ACHIEVED THIS REDUCTION PRINCIPALLY BY INCREASING LOCAL CURRENCY DEPOSIT REQUIREMENTS AND BY GREATER CLIENT SELECTIVITY. ONE BANK REPORTS THAT BEGINNING APRIL 1 IT HAS REQUIRED 100 PERCENT CD BACKING TO OPEN LETTERS OF CREDIT FOR IMPORTERS AND OTHER CLIENTS, WHILE ANOTHER BANK HAS STRONGLY ADVISED ALL CLIENTS WITH OUTSTANDING LETTERS OF CREDIT TO OBTAIN 50 PERCENT CD COVERAGE. THIRD BANK REPORTS THAT IT DESIRES 50 PERCENT CD COVERAGE TO OPEN A LETTER OF CREDIT AND ALSO REQUIRES A COMMITMENT BY THE CLIENT TO ACCEPT LIQUIDATION OF MATURING LETTERS OF CREDIT ACCORDING TO A FORMULA OF 40 PERCENT FROM EXPORT CERTIFICATES AND 60 PERCENT FROM CDS. BANKS REPORT THAT LAST WEEK THE BANCO DE LA NACION CEASED ISSUING LETTERS OF CREDIT ON BEHALF OF ALL CLIENTS (MAINLY STATE ENTERPRISES).

6. THE "SOMETHING EXTRA" RATE. ON TUESDAY, MAY 2, COMMERCIAL BANKERS AGREED JOINTLY THAT EACH BANK COULD DO AS IT PLEASED IN REGARD TO "DIRECTED" FOREIGN EXCHANGE OPERATIONS. COMMERCIAL BANK PRESIDENTS HAD AGREED AT A PREVIOUS MEETING WITH PRESIDENT MORALES BERMUDEZ NOT TO TAKE UNILATERAL AC-

TION TO CHANGE THE OFFICIAL OR GENTLEMEN'S AGREEMENT RATE.
UP TO TWO WEEKS AGO A S/.10-12 BROKERATE FEE PAID BY THE
BUYER VIA THE BANK TO THE SELLER OF EXPORT CERTIFICATES
WAS THE USUAL PRACTICE. LAST WEEK THE BROKERAGE FEE
WAS S/.25-35 PER U.S. DOLLAR. ONE BANK DENIES THAT IT
HAS ENGAGED IN SUCH "UNDER-THE-TABLE" TRANSACTIONS,
BUT ADMITS THAT IT HAS LOST BUSINESS FOR THIS REASON,
ADDING THAT IT MAY BE THE ONLY PERUVIAN COMMERCIAL BANK
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THAT HAS NOT ENGAGED IN "UNDER THE TABLE" PRACTICES.
ON MAY 5 THE CENTRAL BANK ISSUED AN EXCHANGE RESOLUTION
ATTEMPTING TO CURTAIL THIS PRACTICE BUT ONE BANKER TOLD
US THAT HE WAS JUST ASKED TO ACCEPT S/25 PER DOLLAR OVER-
CHARGE FROM OWNER OF AN EXPORT CERTIFICATE IN EXCESS OF
ONE MILLION DOLLARS, AND THAT HE WOULD BUY AT THAT PRICE
AND PASS THE CHARGE ON TO HIS CLIENTS.

7. BANKERS HAVE COMPLAINED OFFICIALLY. IN A DRAFT COPY
OF A LETTER TO PRESIDENT MORALES BERMUDEZ SIGNED BY MOST
OF THE PRESIDENTS OF PERUVIAN COMMERCIAL BANKS IN APRIL
(COPY BEING POUCHED DEPT), BANKERS OBJECTED TO THE THESIS
OF THE CENTRAL BANK (STATED AT AN APRIL 3 MEETING) THAT
PROMPT PAYMENT OF PUBLIC SECTOR DEBT AT THE EXPENSE OF
PROMPT PAYMENT OF PRIVATE SECTOR DEBT WOULD OBTAIN A FAVOR-
ABLE RESPONSE OF THE INTERNATIONAL BANKING COMMUNITY IN
PERU'S CONFLICT WITH THE IMF. IN LETTER BANKERS COMPLAIN
ABOUT THE TOO-HIGH RETENTION OF EXPORT PROCEEDS BY THE
CENTRAL BANK. THEY ALSO STATED (1) THAT "THE FOREIGN EX-
CHANGE AVAILABLE TO COMMERCIAL BANKS IN THE FUTURE WILL
NOT BE ADEQUATE TO COVER PRESENTLY CONTRACTED COMMERCIAL
AND FINANCIAL OBLIGATIONS," (2) THE INATTENTION TO
COLLECTION DOCUMENTS BY THE BANKING SYSTEM UNDERMINES THE
PRESTIGE OF PERUVIAN COMMERCIAL BANKS AND ENDANGERS THE
AVAILABILITY OF THESE CREDITS, AND (3) THAT THEY DOUBTED
THEY WOULD BE ABLE TO GRANT NEW CREDITS, AND THIS WOULD
GRAVELY INJURE PRODUCTION, BUT NOTED THAT REGULATION OF THE
FLOW OF IMPORTS WAS OUTSIDE THEIR FUNCTIONAL COMPETENCY.

8. EVIDENCE ON ARREARAGES. THE BANKERS WE INTERVIEWED
WERE CONCERNED ABOUT GROWTH OF CLIENTS' UNCOVERED ADVANCE
ACCOUNTS BUT UNDER PRESENT CIRCUMSTANCES FELT THERE
WAS LITTLE THEY COULD DO ABOUT IT. A PRIVATE SECTOR
MANUFACTURER REPORTED TO US LAST WEEK THAT HIS SOUNDING
OF PRIVATE SECTOR MANUFACTURERS REVEALED THAT THIS SEC-
TOR'S FOREIGN EXCHANGE OBLIGATIONS ARE APPROXIMATELY
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THREE TIMES HIGHER THAN A YEAR AGO DUE TO THE INCREASE IN THE GOP OBLIGATORY FINANCING REQUIREMENT FROM 90 DAYS TO 180 DAYS (INITIATED IN AUGUST 1977), AND DUE TO INCREASED UNPAID OPEN ACCOUNT ITEMS. ALL BANKERS WE INTERVIEWED BELIEVE THAT THE SCARCITY OF LETTERS OF CREDIT HAS INTERRUPTED NORMAL SERVICING OF OPEN ACCOUNT COLLECTIONS--MANY OF THEM REFINANCED BY MEANS OF LETTERS OF CREDIT IN MORE NORMAL TIMES. THE MAY 10 CARETAS ARTICLE STATES THAT THE ARREARAGE ON LETTERS OF CREDIT IS ON THE ORDER OF \$60 MILLION AND THAT THERE IS NOW AN ADDITIONAL \$70 MILLION IN UNPAID COLLECTIONS. ALTHOUGH NONE OF THE COMMERCIAL BANKERS WE INTERVIEWED STATED THAT THEY HAD AN ARREARAGE, ONE OF THEM BELIEVED THAT COMMERCIAL BANKS AS A WHOLE HAD A NET ARREARAGE OF \$20 MILLION (CALCULATED AS THE NET OF CD'S BACKING DEPOSITED ABROAD LESS OVERDUE ACCOUNTS.)

9. COMMENT: PERU'S FOREIGN EXCHANGE MARKET IS CLEARLY SUFFERING THE EFFECTS OF AN ACUTE SHORTAGE OF DOLLARS, AND THIS SITUATION WILL BECOME EVEN MORE DISORDERLY IF SOME RELIEF IS NOT PROVIDED VERY SOON. BANKERS HERE ARE LOOKING TO A ROLLOVER BY FOREIGN COMMERCIAL BANKS OF SOME \$80-90 MILLION IN PUBLIC SECTOR OBLIGATIONS MATURING IN THE NEXT 90 DAYS (SEE SEPTTEL) WHICH COULD HAVE SIGNIFICANT EFFECT ON DOLLAR AVAILABILITY FOR PRIVATE SECTOR BANKERS HERE. IF SUCH RELIEF IS NOT IMMEDIATELY FORTHCOMING, BANKERS HERE FEAR THAT DEFAULTS ARE A REAL POSSIBILITY. AND, EVEN IF DEFAULTS ARE AVOIDED, EXTREME FINANCIAL CRUNCH COULD CAUSE DISORDERLY INTERRUPTION OF IMPORTS AND IMPORT-DEPENDENT DOMESTIC PRODUCTION.
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